## **Summary**

- An index is a measure, over time, of the average changes in the values of a group of items.
- It comprises of a series of index numbers with the value for the base year = 100.
- An index number measures the percentage change in the value of some economic commodity over a period of time.
- It shows the changes in price, quantity, wages, productivity, expenditure and others at a point of time compared to the base year.
- Index numbers, therefore, are not concerned with absolute values but rather the movement of values.
- Laspeyer's index attempts to answer the question "what is the change in the aggregate value of the base period list of good when valued at a given period prices?"
- The Laspeyer's method of price index is a weighted aggregate price index devised by Laspeyer in 1871 and that is why it is called so. In this method, the weights are determined by quantities in the base period.
- Laspeyer's index is the most widely used index number for practical work.
- The Laspeyer's index is convenient to use on a continuing basis because the weights remain fixed from one period to the next.
- The disadvantage of Laspeyer's index numbers is that it does not take into consideration the consumption pattern.
- The Laspeyer's index has an upward bias as the consumption of items decreases when the prices increase. Hence, by using the base year weights too much weight will be given to those items, which have increased in price the most.
- Similarly, when prices decline the consumers shift their purchases to those items, which decline the most. By using base period weights, too little weight is given to those items, which decrease most in price again overstating the index.
- The Paasche's method gives us the answer for the question "what would be the value of the given period list of goods when valued at base period prices?"
- The Paasches method index number was devised by a German statistician Paasche, was first used in the year 1874, and hence is named after him. In this method, the price index is a weighted aggregative price index in which the weights are determined by the quantities in the given year.
- The difficulty in computing the Paasche index in practice is that revised weights or quantities must be computed each year or each period, adding the data collection expenses in the preparation of the index, hence this method is not used frequently in practice where the number commodities is large.

• People tend to spend less on goods when their prices are rising and the use of Paasche's or current weighing produces an index, which tends to underestimate the rise in price and has a downward bias